

10

Accounting for GST/HST, Payroll, and Income Tax

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After reading this chapter, you should be able to:

- describe different methods for calculating GST/HST and making remittances to the Canada Revenue Agency
- calculate, record, and remit payroll deductions
- explain common income tax considerations

Goods and Services Tax

The goods and services tax is a multi-level, value-added tax that was introduced in Canada on January 1, 1991 by then Prime Minister Brian Mulroney and his finance minister, Michael Wilson. Most Canadians and Canadian companies must pay **GST/HST** on their purchases, including legal fees. Some groups and organizations, such as diplomats, governments, and status Indians, are exempt from paying GST/HST. However, if a false claim for exemption is made by a client, and even if a fake exemption card is presented to avoid paying the tax, you as the business owner still must account for the tax you should have collected.

The provinces of New Brunswick, Nova Scotia, Newfoundland and Labrador, Ontario, and Prince Edward Island, referred to as the participating provinces, harmonized their provincial sales tax with the GST to create the harmonized sales tax (HST). The current rate for HST in Ontario for April 1, 2013 and subsequent years is 13 percent, which includes the 5 percent federal rate and the 8 percent provincial rate.

As mentioned in Chapter 1, as a paralegal you are considered a **small supplier**, exempted from collecting GST/HST if your total annual revenues from all of your businesses are \$30,000 or less.

Remitting GST/HST to the Receiver General

To complete a GST/HST return, you need to know the following amounts:

- Your total fees and disbursements or other revenues on which you charge GST/HST.
- The amount of GST/HST you charged (even if it was not collected).
- The amount of GST/HST you paid or is payable on purchases you made for the business. This is referred to as your input tax credit (ITC).
- You might also have to include other amounts on your GST/HST report, such as installments you paid during the year or other adjustments being claimed.

If you are a sole proprietor with a fiscal year-end of December 31, and you have an annual reporting period for GST/HST purposes, your payment is due no later than April 30, although the return is not due until June 15. Payments may be made to the Receiver General using online banking, at a financial institution, or by mail. The Canada Revenue Agency does not accept credit cards. A penalty plus interest is charged on any balance owing if the return is not received by the CRA on time. The penalty is calculated as 1 percent of the amount owing, plus 25 percent of that amount multiplied by the number of months the return is overdue, up to 12 months.

Maintenance of Records

Usually, you have to keep all sales and purchase invoices and other **records** related to your business operations and the GST/HST for six years from the end of the year to which they relate. If you want to destroy your records after six years, the CRA recommends that you send a written request and wait for written approval to do so. As a registrant, you also need correct information on the invoices you get from your suppliers to support your **input tax credit (ITC)** claims. Registered businesses from which you purchase goods or services must provide invoices showing their GST/HST registration number and other required information. You can verify that a supplier provided you with a valid GST/HST number by using the CRA's online GST/HST Registry. The CRA administers an audit program during which auditors may ask to see your records. During an audit, the CRA will make sure that you have charged and reported the GST/HST when required, and that you are entitled to all the ITCs that you claim on your return.

Many rules apply to what can and cannot be claimed as an ITC. As a guideline, claim only those tax-deductible purchases that are authorized under the *Income Tax Act* on which GST/HST is charged. For example, under the *Income Tax Act*, the deduction for meals and entertainment expenses is limited to 50 percent of the cost of the meals and entertainment. Likewise, the ITCs you can claim for this expense are also limited to 50 percent of the amount paid. If you qualify to claim home office expenses for income tax purposes, you can claim the ITCs applicable to the portion of the home expenses you are allowed to deduct from your **income** for calculating your net income for tax purposes. A special calculation is required if you wish to claim GST/HST paid on the purchase of a vehicle. The amount you are allowed for GST/HST is based on what you are entitled to claim based on the permissible capital cost allowance (CCA). You are advised to check the CRA website information on claiming ITCs or speak to a tax professional to ensure the amounts you claim are allowed.

Methods for Calculating GST/HST Remittance

There are three methods used for tracking GST/HST:

- The regular method
- The simplified method
- The quick method

The quick method will not be discussed here because persons who provide legal, accounting, or actuarial services in the course of their professional practice are not permitted to use it.

A paralegal may use either the regular or the simplified method for calculating the amount of GST/HST that must be remitted to the Receiver General.

Regular Method

If you plan to use the regular method for submitting GST/HST remittances, you should ensure that your journals and ledgers are set up with the necessary columns for tracking GST/HST billed to clients and GST/HST paid or payable on purchases by the firm. This will provide you with the data you need for completing the returns. To use the regular method for calculating the amount of GST/HST you need to remit, you will need to know

- the total amount of fees billed to clients on which GST/HST was charged over the reporting period;

GOODS AND SERVICES TAX / HARMONIZED SALES TAX (GST/HST) RETURN WORKING COPY

Do not use this printer-friendly version to file your return or to make payments at your financial institution.

Business Number	Name
Reporting period From: to:	Due date

Working copy (for your records)

- Copy your Business Number, the reporting period, and the amounts from the **highlighted** line numbers in this worksheet to the corresponding boxes in your GST/HST return.

Enter your total **sales and other revenue**. Do not include provincial sales tax, GST or HST.
If you are using the Quick Method of accounting, include the GST or HST.

101

100

NET TAX CALCULATION

Enter the total of all **GST and HST amounts that you collected or that became collectible** by you in the reporting period.

103**104**

Total GST/HST and adjustments for period (add lines 103 and 104)

105

Enter the GST/HST you paid or that is payable by you on qualifying expenses (**input tax credits - ITCs**) for the current period and any eligible unclaimed ITCs from a previous period.

106**107**

Total ITCs and adjustments (add lines 106 and 107)

108

NET TAX (subtract line 108 from line 105). If the result is negative, enter a minus sign in the separate box next to the line number.

109

OTHER CREDITS IF APPLICABLE

Do not complete line 111 until you have read the instructions.

Enter any **instalment and other annual filer payments** you made for the reporting period.
If the due date of your return is June 15, see the instructions.

110**111**

Total other credits (add lines 110 and 111)

112

BALANCE (subtract line 112 from line 109). If the result is negative, enter a minus sign in the separate box next to the line number.

113 A

OTHER DEBITS IF APPLICABLE

Do not complete line 205 or line 405 until you have read the instructions.

Enter the total amount of the GST/HST **due on the acquisition of taxable real property**.

205**405**

Total other debits (add lines 205 and 405)

113 B

BALANCE (add lines 113 A and 113 B). If the result is negative, enter a minus sign in the separate box next to the line number.

113 C

Line 114 and line 115: If the result entered on line 113 C is a negative amount, enter the amount of the refund you are claiming on line 114. If the result entered on line 113 C is a positive amount, enter the amount of your payment on line 115.

REFUND CLAIMED

PAYMENT ENCLOSED

114**115**

Instructions

Line 110

Annual filer with a June 15 due date: If you are an individual with business income for income tax purposes and have a December 31 fiscal year-end, the due date of your return is June 15. However, any GST/HST you owe is payable by April 30. This payment should be reported on line 110 of your GST/HST Tax Return.

Line 111: Some rebates can reduce or offset your amount owing. Those rebate forms contain a question asking you if you want to claim the rebate amount on line 111 of your GST/HST Tax Return. Tick **yes** on the rebate form(s) if you are claiming the rebate(s) on line 111 of your GST/HST Tax Return. If you file your return electronically, send the rebate application by mail to the Summerside Tax Centre.

Line 205: Complete this line **only** if you purchased taxable real property for use or supply primarily (more than 50%) in your commercial activities and you are a GST/HST registrant (other than an individual who purchases a residential complex) or you purchased the property from a non-resident. If you qualify for an input tax credit on the purchase, include this amount on line 108.

Line 405: Complete this line **only** if you are a GST/HST registrant who has to self-assess GST/HST on an imported taxable supply or who has to self-assess the provincial part of HST.

FIGURE 10.1 GST/HST return working copy. Reproduced with permission of the Minister of Public Works and Government Services Canada, 2015.

- the total amount of GST/HST you charged to clients, whether or not it has been collected;
- the total amount you paid or is payable on tax-deductible purchases for GST/HST; and
- the difference between the amount of GST/HST collected from clients and the amount of GST/HST paid or payable for purchases. This is the amount of net tax that either needs to be remitted or for which you are entitled to a refund.

If you are using legal software for accounting purposes, the calculation of these amounts and preparation of a report is usually done automatically. Figure 10.1, above, shows the GST/HST return working copy that is available on the CRA website.¹

Simplified Method

When you use the simplified method, your bookkeeping records do not need to show the purchase price of goods and GST/HST paid separately. To be eligible to use this method, your annual fees income and your purchases must be \$1 million or less. To calculate your GST/HST, add up your ITC-eligible **business expenses**, including the GST/HST paid. You may not include expenses on which no GST/HST is payable, such as salaries, and can claim the GST/HST charged only on purchases deductible as legitimate business expenses under the *Income Tax Act*. For example, if you are living in Ontario, which has a combined GST/HST rate of 13 percent (5 percent federal and 8 percent provincial), the simplified method calculation would be as follows:

Description	Expenses
Rent (includes HST)	\$1,070.00
Salaries (HST does not apply)	3,000.00
Insurance (HST does not apply)	50.00
Advertising (HST included)	214.00
Office supplies (HST included)	230.00
Total purchases and expenses	\$4,564.00
Step 1	
• Add all purchases and expenses including the HST (GST and PST)	\$4,564.00
• Subtract non-taxable items (salaries and insurance)	–3,050.00
Taxable expenses	\$1,514.00
Step 2	
• Multiply taxable expenses on which you paid 13 percent HST by 13/113 to calculate the input tax credit	\$174.18

FIGURE 10.2 Simplified calculation of GST/HST

¹ Canada Revenue Agency, “Goods and Services Tax/Harmonized Sales Tax (GST/HST) Return Working Copy,” online: <<http://www.cra-arc.gc.ca/tx/bsnss/tpcs/gst-tps/bpsbch/rtrns/rtrnwkcpy-eng.pdf>>.

Calculate your net tax for each GST/HST reporting period and report this on your GST/HST return. To do so, calculate

- the GST/HST collected or that became collectible by you on the fees billed during the reporting period and
- the GST/HST payable using the simplified calculation above; then
- take the difference between these two amounts, including any adjustments, to arrive at your net tax.

A positive amount must be remitted to the Receiver General. If the GST/HST paid is more than the GST/HST you charged or collected, you can claim a refund for the difference.

Note that the GST/HST rate used above is for Ontario, and the multiplier of 13/113 will vary with the GST/HST rates for your province.

Deciding which method is best for you for calculating GST/HST is complicated. You may wish to speak to an accountant when making a decision.

Remitting GST/HST

Before the end of each GST/HST reporting period, you will receive a form to complete from the CRA that must be filled in and returned along with any payment owing. If you file quarterly, you must send the return along with the amount owing before the end of the following month. That is, a report covering January to March would have to be filed before the end of April. If you file annually, the report must be sent within three months after the end of the one-year period. Remittances may be made by filing online, at a financial institution, or by mail.

Payroll

Salaries can represent a large part of the operating expenses for a firm. Employers are responsible for deducting Canada Pension Plan (CPP) contributions, employment insurance (EI) premiums, and income tax from remuneration paid to employees and for remitting the deductions to the Canada Revenue Agency along with the required reports. If you do not fulfill your obligations or comply with payroll requirements, you may be assessed a penalty with interest, or incur other consequences. On prosecution, a person can be fined from \$1,000 to \$25,000 or fined and imprisoned for a term of up to 12 months. The CRA can assess a penalty of 10 percent of the amount of CPP, EI, and income tax that was not deducted and will apply a penalty of 20 percent to second or later failures, under certain circumstances.

When you hire an employee, you must:

- obtain your employee's social insurance number (SIN) and
- obtain from your employee a completed Form TD1, Personal Tax Credits Return.²

The Payroll Process

Gross pay will be established with the employee at the time of hire. It may be a salary based on various pay periods, usually weekly, biweekly, or monthly. When hiring an employee, you should ensure there is a clear understanding of the rate being paid, the hours of work, and other benefits, such as sick days and vacation time.

² Canada Revenue Agency, "Filing Form TD1, Personal Tax Credits Return," online: <http://www.cra-arc.gc.ca/tx/bsnss/tpcs/pyrll/hwpyrllwrks/stps/hrng/td1/menu-eng.html>.

Suppose Justin Case hires an assistant who will work from 8:30 to 5:00 every day (with one hour off for lunch) at an hourly rate of \$20 per hour. That would make for a 7.5-hour day or 37.5 hours a week. At the rate of \$20 an hour, this would yield a gross pay of \$750 a week. Justin will need to determine how frequently the employee will be paid to determine the gross pay for each pay period before the **payroll deductions** at source can be calculated.

Gross pay	\$750 per week x 52 weeks	\$39,000
Weekly	\$39,000/52 pay periods	\$750
Bi-weekly	\$39,000/26 pay periods	\$1,500
Twice a month	\$39,000/24 pay periods	\$1,625
Monthly	\$39,000/12 pay periods	\$3,250

FIGURE 10.3 Calculation of gross pay

TD1 Form

When hiring an employee, you must get your employee's social insurance number and have him or her fill in the TD1 form. This form is used to obtain the employee's claim code to determine the amount of income tax to be deducted from an individual's employment income. There are two forms that must be completed, one federal and one provincial or territorial. Employees complete the forms and give them to their employer, who should keep a completed form with their records.

For the purposes of this chapter, we will assume that Justin's assistant, Judith Wright, has completed the TD1 form and arrived at a claim code 1, because she was previously unemployed and has **personal deductions** she could claim, such as tuition fees and childcare expenses.

Payroll Calculator

The easiest way to calculate source deductions that must be taken from the employee's paycheque and the amounts you will need to remit as employer is to use the Payroll Deductions Online Calculator on the CRA website at <<http://www.cra-arc.gc.ca/esrvc-srvce/tx/bsnss/pdoc-eng.html>>. The CRA also has tables that can be used manually to look up the amount that must be deducted.

EXAMPLE 1

Justin Case went to the CRA website and used the payroll calculator to find out what deductions had to be taken and how much he would have to remit to the CRA for the pay period. Figure 10.4 shows the report obtained using the payroll calculator.

The report indicates that on a gross paycheque of \$1,625.00, the amount of \$150.23 must be deducted for federal taxes and \$74.82 for provincial taxes, totalling \$225.05. The deduction from

gross pay for CPP is \$73.22 and for EI is \$30.55. The total deductions come to \$328.82, and Judith will receive a paycheque of \$1,296.18.

Figure 10.5 shows the general journal entries required to record the salaries expense, the employer's payroll contributions, and the employer's remittance to the Receiver General for the salaries paid on December 15. The payroll deductions calculations from Figure 10.4 provide the information you need to make these entries.

Employee's name: Judith Wright Employer's name: Justin Case, Paralegal Pay period frequency: Twice a month (24 pay periods a year) Date the employee is paid: 2014-12-15 Province of employment: Ontario Federal amount from TD1: Minimum—11,138.00 (Claim code 1) Provincial amount from TD1: Minimum—9,670.00 (Claim code 1)			
Salary or wages income (assume \$750 gross/week)		1,625.00	
Total cash income			1,625.00
Taxable income for the pay period		1,625.00	
Pensionable earnings for the pay period		1,625.00	
Insurable earnings for the pay period		1,625.00	
Federal tax deduction (Payroll Tax Table, D)	150.23		
Provincial tax deduction (Payroll Tax Table, E)	74.82		
Total tax deductions		225.05	
CPP deductions (Payroll Tax Table, B)		73.22	
EI deductions (Payroll Tax Table, C) <i>The employer's EI premium is equal to 1.4 times the employee's premium, unless a reduced rate applies.</i>		30.55	
Total deductions			328.82
Net amount			1,296.18
Employer Remittance Summary			
Employee CPP contributions	73.22		
Employer CPP contributions	73.22		
Subtotal of Canada Pension Plan (CPP)		146.44	
Employee EI contributions	30.55		
Employer EI contributions	42.77		
Subtotal of Employment Insurance (EI)		73.32	
Tax deductions		225.05	
For this calculation, remit this amount		444.81	

FIGURE 10.4 Payroll deductions online calculation

STEP 1

December 15—This entry reflects that Judith Wright was paid \$1,625.00 but received a cheque for \$1,296.18 because the source deductions for income tax and her share of CPP and EI were taken off her paycheque. However, the firm is entitled to write off \$1,625.00 as a salaries expense because that is its cost.

STEP 2

December 15—The firm contributes the employer's share of EI and CPP for Judith and is entitled to write those expenses off as a tax-deductible expense. Because the remittance is not sent immediately, it is posted to the payroll clearing account as a liability.

STEP 3

December 31—When the firm forwards the source deductions taken from Judith's salary on the 15th plus the employer's share it owes, the liability account Payroll Clearing (#217) is debited, thus reducing it to zero, and a cheque payable to the Receiver General for the amount owing to the Canada Revenue Agency is credited to the general bank account.

Justin Case, Paralegal General Journal					GJ6
Date 20**		Description	PR	Debit	Credit
Dec.	15	Salaries Expense	511	1,625.00	
		Payroll Clearing, Income Taxes Payable	217		225.05
		Payroll Clearing, CPP Payable	217		73.22
		Payroll Clearing, EI Payable	217		30.55
		General Bank Account	100		1,296.18
		<i>To record payroll for Dec. 15</i>			
	15	CPP Expense	518	73.22	
		EI Expense	517	42.77	
		Payroll Clearing, CPP Payable	217		73.22
		Payroll Clearing, EI Payable	217		42.77
		<i>To record employer's payroll contributions</i>			
	31	Payroll Clearing	217	444.81	
		General Bank Account	100		444.81
		<i>To record remittance to Receiver General for December</i>			
		Totals		<u>2,185.80</u>	<u>2,185.80</u>

FIGURE 10.5 General journal entries recording payroll

Vacation Pay and Vacation Time

Employees are entitled to be paid vacation pay after their first full year of employment. Typically in Ontario, an employee is entitled to a minimum payment of 4 percent of gross annual earnings. The employee accrues vacation pay as he or she earns wages regardless of vacation time taken, not taken, or carried over.

Normally, employees take the time off and receive a regular paycheque while they are away. However, if their employment is terminated and vacation pay is owed, this must be paid and will be subject to the source deductions and employer contributions to CPP and EI described above.

The normal minimum vacation time is two weeks in each year that the employee is employed. The employment contract or policy agreement should deal with vacation time that is not taken or is carried over past the prescribed or agreed-upon deadline to take such vacation.³

3 Ontario Ministry of Labour, "Vacation Time and Vacation Pay," online: <<http://www.labour.gov.on.ca/english/es/pubs/guide/vacation.php>>.

Taxable Benefits

Some employers provide **taxable benefits** for their employees, such as medical and dental coverage and life insurance premiums. Some of these benefits are deemed to be taxable benefits in the hands of an employee and will be included on the T4 slip issued to the employee at the end of the year.

T4 Information Return

On or before the last day of February in each year, you must file a T4 **information return** with the CRA and provide each of your employees with a T4 slip for income tax purposes. A copy of each T4 slip prepared, as well as a T4 summary of remuneration paid, must be sent to the CRA. These forms can be obtained online on the CRA website.

Income Tax

Legal Requirements for Keeping Records

All records for **income tax** purposes, such as paper documents as well as those stored in an electronic medium (such as on computer disk), must be kept in Canada or made available in Canada at the request of the CRA. The records must be in English or French.

A business is required to keep orderly records of all income received. All receipts, invoices, vouchers, and cancelled cheques indicating outlays of money must also be kept. Such outlays include

- salaries and wages,
- operating expenses such as rent, advertising, and capital expenditures, and
- miscellaneous items such as charitable donations.

Records must be permanent and contain a systematic account of income, deductions, credits, and other information needed to file income tax and GST/HST returns. Incomplete records that use approximates instead of exact amounts are not acceptable. The records must

- allow you to determine how much tax you owe, or the tax, duties, or other amounts to be collected, withheld, or deducted, or any refund or rebate you may claim; and
- be supported by vouchers or other necessary source documents.

If you do not keep your receipts or other vouchers to support your expenses or claims, and there is no other evidence available, the CRA will probably reduce the expenses or claims you have made.

The Six-Year Requirement

If tax returns are filed on time, records must be retained (other than certain documents for which there are special rules) for six years from the end of the last **tax year** to which they relate. You must keep every record necessary for dealing with an objection or appeal until it is resolved and the time for filing any further appeal has expired, or until the six-year period mentioned above has expired, whichever is later.

Types of Operating Expenses

Personal or Living Expenses

In most cases, you cannot deduct personal and living expenses, except for travelling expenses you incur in the course of carrying on a business while away from home. The general rule is that you cannot deduct outlays or expenses that are not related to earning business income.

Prepaid Expenses

A prepaid expense is an expense you pay ahead of time. If you use the accrual method of accounting, claim any expense you prepay in the year or years in which you receive the related benefit.

Accounting and Legal Fees

You can deduct the fees you incurred for external professional advice or services, including consulting fees. You can deduct accounting and legal fees you incur to get advice and help in keeping your records. You can also deduct fees you incur for preparing and filing your income tax and GST/HST returns.

Advertising Expenses

You can deduct expenses for advertising, including advertisements in Canadian newspapers and on Canadian television and radio stations.

Bad Debts

You can deduct an amount for a **bad debt** if

- you had determined that an account receivable is a bad debt in the year, and
- you had already included the receivable in income.

For more information, see Interpretation Bulletin IT-442R, “Bad Debts and Reserves for Doubtful Debts.”⁴

Business Tax, Fees, Licences, and Dues

You can deduct your annual licence fees, law association membership dues, and any business taxes you incur to run your business. However, you cannot deduct club membership dues (including initiation fees) if the main purpose of the club is to provide dining, recreational, or sporting facilities for its members.

Insurance Expenses

You can deduct all regular commercial insurance premiums you incur on any buildings, machinery, and equipment that you use for your business. Life insurance premiums are generally not deductible.

⁴ Canada Revenue Agency, “Bad Debts and Reserves for Doubtful Debts,” online: <<http://www.cra-arc.gc.ca/E/pub/tp/it442r/it442r-e.html>>.

Interest and Bank Charges

You can deduct the interest you incur on money you borrow to run your business. There is a limit on the interest you can deduct on money you borrow to buy a passenger vehicle.

Maintenance and Repairs Expenses

You can deduct the cost of labour and materials for any minor repairs or maintenance done to property you use to earn income. However, you cannot deduct the value of your own labour. You cannot deduct costs you incur for repairs that are capital in nature, but you may be able to claim CCA on the repaired property. A capital expense generally gives a lasting benefit or advantage. For example, the cost of putting vinyl siding on the exterior walls of a wooden house is a capital expense.

Meals and Entertainment Expenses

The maximum you can claim for food, beverages, and entertainment expenses is 50 percent of either the amount you incur or an amount that is reasonable in the circumstances, whichever is less.

The 50 percent limit also applies to the cost of your meals when you travel or go to a convention, conference, or similar event. However, special rules can affect your claim for meals in these cases. The 50 percent limit does not apply if you incur meal and entertainment expenses to provide a Christmas party or similar event and you invite all your employees from a particular location; however, you are limited to six of these events each year. Also, the 50 percent limit does not apply to meal and entertainment expenses you incur for a fund-raising event that was mainly for the benefit of a registered charity.

Entertainment expenses include tickets and entrance fees to an entertainment or sporting event, gratuities, cover charges, and room rentals such as for hospitality suites. For more information, see Interpretation Bulletin IT-518R, "Food, Beverages and Entertainment Expenses."⁵

Motor Vehicle Expenses

When you are claiming motor vehicle expenses, note that travel from home to the office is not considered travel for business purposes.

You can deduct expenses you incur to run a motor vehicle that you use to earn business income. However, several factors can affect your deduction. The kind of vehicle you own can affect the expenses you deduct. You can deduct motor vehicle expenses only when they are reasonable and you have receipts to support them. The types of expenses you can deduct include the following:

- Fuel and oil
- Maintenance and repairs
- Insurance
- Licence and registration fees
- Capital cost allowance
- Interest you pay on a loan used to buy the motor vehicle
- Leasing costs

⁵ Canada Revenue Agency, "Food, Beverages and Entertainment Expenses," online: <http://www.cra-arc.gc.ca/E/pub/tp/it518r/it518r-e.pdf>.

Figure 10.6 shows the calculation of motor vehicle expenses for Justin Case. The deductible business portion of Justin's vehicle expenses is \$4,770. He can also include additional fees he pays for business, such as parking fees of \$40 or a supplementary business insurance cost of \$100, to increase his deduction to \$4,910.

Calculation of Motor Vehicle Expenses	
Kilometres driven to earn business income	27,000
Total kilometres driven in the year	30,000
Percentage for business use: $27,000/30,000 \times 100$	90%
Expenses:	
Gas and oil	2,400
Insurance	1,900
Interest	800
Maintenance and repairs	200
Total expenses for the car	5,300
Calculation of deduction for tax purposes: $\$5,300 \times 90\%$	4,770

FIGURE 10.6 Calculating vehicle expenses

To get the full benefit of your claim for a vehicle, you must keep a record of the total kilometres you drive for personal use and the kilometres you drive to earn business income. For each business trip, list the date, destination, purpose, and number of kilometres you drive. Record the odometer reading of your vehicle at the start and end of the **fiscal period**.

You are allowed to claim capital cost allowance on the cost of the vehicle up to a maximum value of \$30,000. The rate of depreciation allowed is 30 percent with an adjustment in the year of acquisition, which reduces the amount you are allowed to deduct for CCA by one-half.

Leasing Costs for a Passenger Vehicle

You can deduct amounts you incur to lease a motor vehicle you use to earn income. When you use a passenger vehicle to earn income, there is a limit on the amount of the leasing costs you can deduct. If the lease agreement for your passenger vehicle includes items such as insurance, maintenance, and taxes, include them as part of the lease charges.

Work Space in Home Expenses

If you rent the home in which you have a home office, you can deduct the part of the rent and any expenses you incur that relate to the work space. The amount you can deduct for business-use-of-home expenses cannot be more than your net income from the business before you deduct these expenses. In other words, you cannot use these expenses to increase or create a business loss.

EXAMPLE 2

Justin has space in his home devoted to the sole purpose of running his business. The business uses an area of 35 square metres. The house has 800 square metres, and the annual household expenses are \$5,800.

The calculation to determine the tax deduction for use of the space is as follows:

$$35/800 \text{ square metres} \times \$5,800 \text{ expenses} = \$253.75$$

Justin can deduct a total of \$253.75 for work space in home expenses. Because capital gain and recapture rules will apply if he deducts CCA on the business-use part of his home and he later sells the home, he should seek professional advice before doing this.

Computer and Other Equipment Expenses

If you lease computers, cellular telephones, fax machines, and other equipment, you can deduct the percentage of the lease costs that reasonably relate to earning your business income. You can also deduct the percentage of airtime expenses for a cellular telephone that reasonably relate to earning your business income. If you buy a computer, cellular telephone, fax machine, or other such equipment, you cannot deduct the actual cost. But you can deduct CCA and interest you paid on money you borrowed to buy this equipment that reasonably relates to earning your business income.

Convention Expenses

You can deduct the cost of going to a maximum of two conventions a year. The conventions must

- relate to your business or professional activity and
- be held by a business or professional organization within the geographical area where the organization normally conducts its business.

This second requirement may not apply if an organization from another country sponsors the convention and the convention relates to your business or professional activity.

Sometimes, convention fees include the cost of food, beverages, or entertainment. However, the convention organizer may not show these amounts separately on your bill. If this is the case, subtract \$50 from the total convention fee for each day the organizer provides food, beverages, or entertainment. You can deduct this daily \$50 amount as a meal and entertainment expense. However, the 50 percent limit applies to the daily \$50 amount.

EXAMPLE 3

Justin attended a two-day convention in May that cost him \$600. The organizer did not indicate what part of the \$600 fee was for food and entertainment. The CRA allows you to claim the following convention expenses:

Cost of meals and entertainment			
Two days at \$50/day = \$100 allowed at 50%	\$50	} Total deduction \$550	
Cost of convention (\$600 – \$100 meals)	\$500		

Office Expenses

You can deduct the cost of office expenses, which include small items such as pens, pencils, paper clips, stationery, and stamps. Office expenses do not include larger items such as filing cabinets, chairs, and desks, which are capital items and can be claimed using CCA.

Salaries, Including Employer's Contributions

You can deduct salaries and the employer's share of contributions you pay to employees. You report these salaries by the end of February on a T4 slip (statement of remuneration paid) or T4A slip (statement of pension, retirement, annuity, and other income).

Amounts paid or payable to you or your partners are not deductible and cannot be expensed. They are considered drawings. A drawing is any withdrawal of cash, other assets, or services of a business by the proprietor or partners. This includes such transactions by the proprietor or partners (or family members) as withdrawing cash for non-business use, and using business assets or services for personal use. Professionals must include the cost or value of personal use of business assets or services in their drawings for the year rather than showing them as an expense in their books.

Salaries Paid to Family Members

You can deduct the salary you pay to your child or spouse (including common law partner) as long as you meet all these conditions:

- You actually pay the salary.
- The work your child or spouse does is necessary for earning business or professional income.
- The salary is reasonable when you consider your child's age, and the amount you pay is what you would pay someone else.

Keep documents to support the salary you pay to your child. If you pay your child by cheque, keep the cancelled cheque. If you pay cash, have the child sign a receipt. You can also deduct the salary you pay to a spouse. When you pay your spouse a salary, use the same rules that apply to paying your child. Report the salaries you pay to your children and spouse on T4 slips, the same as you would for other employees. However, you cannot claim as an expense the value of board and lodging you provide to your dependent children or spouse.

Telephone and Utilities Expenses

You can deduct expenses for telephone and utilities, such as gas, oil, electricity, and water, if you incurred the expenses to earn income. You can also claim expenses for utilities that are related to the business use of work space in your home.

Deductions and Remittances

To be able to deduct a business expense, you must have carried on a business in the fiscal period in which the expense was incurred. Because of this, you must be very clear about the date your business started. Determining exactly what you can claim as a start-up expense can be difficult.

Capital Gains

If you sell a property for more than it cost, you may have a capital gain, which is taxable.

TAX TIP

The Canada Revenue Agency has a number of tax information videos for individuals and small businesses on topics such as preparing your income tax and benefit return, and reporting business income and expenses. To watch these videos, go to <<http://www.cra.gc.ca/videogallery>>. Videos that provide helpful information on filing of HST/GST for new businesses are found at <<http://www.cra-arc.gc.ca/vdgllry/bsnss/srs-gsthst-tpstvh-eng.html>>.

CHAPTER SUMMARY

Taxes are a fact of life that most of us have come to accept, but who knew that working as a paralegal would turn you into a tax collector? In this chapter we have examined your responsibilities with regard to collection and remittance of GST/HST, collection and remittance of payroll deductions, and payment of income taxes. These tasks are time-consuming, and you must keep yourself informed because tax laws change frequently. Although rates may change, the basic principles remain fairly constant.

Remember that although you are not paid to collect and remit taxes for the government, you will certainly be penalized if you fail to complete these tasks in a correct and timely manner. It is advisable for licensees to consult with an accountant when the time comes to file tax returns each year.

KEY TERMS

bad debt, 257	input tax credit (ITC), 249
business expenses, 251	payroll deductions, 253
fiscal period, 259	personal deductions, 253
gross pay, 252	records, 249
GST/HST, 248	small supplier, 248
income, 249	tax year, 256
income tax, 256	taxable benefits, 256
information return, 256	

FURTHER READING

Canada Revenue Agency, Form T2125, "Statement of Business or Professional Activities," online: <<http://www.cra-arc.gc.ca/E/pbg/tf/t2125/t2125-14e.pdf>>.

Canada Revenue Agency, "GST/HST Videos for Businesses," online: <<http://www.cra-arc.gc.ca/tx/bsnss/tpcs/gst-tps/vds-eng.html>>. See the following video resources:

- GST/HST Information for a New Small Business
- Payroll Information for a New Small Business
- Preparing T4 and T4A Information Returns—Slips and Summaries

Canada Revenue Agency, Guide T4002(E), "Business and Professional Income," 2014, online: <<http://www.cra-arc.gc.ca/E/pub/tg/t4002/t4002-14e.pdf>>.

Canada Revenue Agency, "Videos and Recorded Webinars for Businesses," online: <<http://www.cra-arc.gc.ca/vdglly/bsnss/menu-eng.html>>. See the following video resources:

- Series: Reporting Business Income and Expenses
- Series: Payroll Information for a New Small Business

PUT IT INTO PRACTICE

Case Example: Employer, Small Business, and Professional Responsibilities

Review the online CRA resource Checklist for New Small Businesses (<<http://www.cra-arc.gc.ca/tx/bsnss/sm/chcklst-eng.html>>) and help Ann Litigate create a customized checklist for her CRA filings as an employer and as a small business proprietor and legal professional.

REVIEW QUESTIONS

True or False

- _____ 1. GST/HST is remitted on the total amount of GST/HST charged and collected.
- _____ 2. The simplified method of calculating GST/HST payable does not need to show the purchase price of goods and GST/HST paid separately but is based on eligible business expenses based on a prescribed formula.
- _____ 3. Paralegals have the option of using the quick method to calculate the amount of GST/HST to be paid.
- _____ 4. Legal and accounting fees incurred by a business owner for external advice can be deducted as a business expense.
- _____ 5. Business records should be maintained for a minimum period of six years from the end of the last tax year to which such records relate.
- _____ 6. Payroll calculations include the withdrawals made by the business owner from the business.
- _____ 7. Input tax credits can be claimed only on purchases made by the business.
- _____ 8. Salaries and the employer's share of contributions paid to employees can be deducted as business expenses.
- _____ 9. A small supplier for GST/HST purposes is required to register for GST/HST as soon as it commences operation, regardless of its total annual revenue.
- _____ 10. A business can claim only those expenses or portions of such expenses that are related or attributed to earning income for the business.

Short Answer

Give a full answer for each question:

- 1. What are the record-keeping requirements for business records as stated by the Canada Revenue Agency?
- 2. What are some examples of ineligible business expenses?
- 3. What are the steps involved in calculating GST/HST payable using the regular method?
- 4. What are the steps involved in calculating payroll?

PRACTICE EXERCISES

Practice Exercise 10.1

Based on the entries below in the fees journal and general disbursements journal, prepare a GST/HST worksheet for the month of January 20** according to the regular method. The worksheet is based on the GST/HST return working copy shown in Figure 10.1.

Fees Journal (Service Revenue)							
Date 20**		Invoice #	Client	Fees Billed	Disbursements Billed	HST Billed (13% ON)	Total Amount Billed
Jan.	1	400	L. Forte	500.00	60.00	72.80	632.80
	3	401	L. Bailey	1,000.00	120.00*	130.00	1,250.00
	5	402	R. Smythe	0.00	120.00*	0.00	120.00
	10	403	C. Schultz	5,000.00	0.00	650.00	5,650.00
	15	405	L. Pepino	1,500.00	0.00	195.00	1,695.00
	18	406	R. Saunders	800.00	300.00	143.00	1,243.00
	25	407	B. Enders	2,400.00	160.00	332.80	2,892.80
Totals:				11,200.00	760.00	1,523.60	13,483.60

* HST not applicable

General Disbursements Journal							
Date 20**		Paid To	Description	Method of Payment	Amount Paid	HST Paid/ Payable (13% ON)	Total Amount Paid
Jan.	1	Magnum Office Manager	A. Litigate—Paid rent, invoice #1001	Chq. #217	1,000.00	130.00	1,130.00
	7	ATB Web Services	A. Litigate—Paid invoice #A0-111	Chq. #218	120.00	15.60	135.60
	15	A. Booth, secretary	A. Litigate—Paid salary expense*	Chq. #219	1,000.00	0.00	1,000.00
	15	ABC Insurance	A. Litigate—Paid invoice #501	Chq. #220	165.00	21.45	186.45
	25	Centrum Parking	A. Litigate—Paid monthly parking invoice #AA123	Chq. #221	100.00	15.00	115.00
	29	SSI Computers and Electronics	A. Litigate—Paid for computer equipment	Chq. #223	700.00	105.00	805.00
	30	A. Booth, secretary	A. Litigate—Paid salary expense*	Chq. #224	1,000.00	0.00	1,000.00
	31	AAA Advertising	A. Litigate—Paid invoice #A0-112	Chq. #226	85.00	12.75	97.75
Totals:					4,170.00	299.80	4,469.80

* HST not applicable

Net GST/HST Tax Payable	
Total Fees Billed	
Total Disbursements Billed	
Total GST/HST Charged	
Total Purchases (tax-deductible, ITCs)	
Total GST/HST paid or payable on tax-deductible purchases	
Net GST/HST Tax	

GST/HST Worksheet, Net GST/HST Calculation (for the Month of January 20**)				
Total GST/HST Collected or Collectible	Line 103	\$		complete
Adjustments	Line 104	\$		complete, if applicable
	Line 105		\$	add Lines 103 and 104
Total GST/HST Paid or Payable for Eligible Expenses	Line 106	\$		complete
Adjustments	Line 107	\$		complete, if applicable
Total ITCs	Line 108		\$	add Lines 106 and 107
Net GST/HST	Line 109		\$	subtract Line 108 from Line 105

PRACTICE**EXCEL**

Practice Exercise 10.2

Using the reference sheets supplied, analyze and discuss parts 2, 3, 5, and 6 of a draft Statement of Business or Professional Activities (CRA Form T2125, which is usually prepared by an accountant) based on the following information provided in Chart 1 (Income Statement) and Chart 2 (GST/HST Collected in Respect of Professional Income and Business Expenses).

Note: Parts 1 and 4 of this form relate to business income; paralegals should complete the sections relating to professional income.

Chart 1: Income Statement

Ann Litigate Paralegal Services Income Statement for the Period Ended December 31, 20**		
Income		
Fees Earned, Including HST and WIP*		\$66,105
Expenses		
Accounting and Bookkeeping	\$2,000	
Depreciation Expense	1,360	
Insurance—Professional Liability	2,500	
Membership/Professional Dues	2,000	
Office Supplies/General Expense	4,000	
Rent Expense	12,000	
Salaries Expense	25,000	
Telephone Expense	800	
Motor Vehicle Expense†	<u>4,770</u>	
Total Expenses		<u>54,430</u>
Net Income (Loss)		<u>\$11,675</u>

* WIP = work in progress

† From Figure 10.6

Chart 2: GST/HST Collected in Respect of Professional Income and Business Expenses

Period	Sales/ Disbursements	GST/HST	Total Sales
First quarter (January 1 to March 31)	\$19,500	\$2,535	\$22,035
Second quarter (April 1 to June 30)	15,000	1,950	16,950
Third quarter (July 1 to September 30)	10,000	1,300	11,300
Fourth quarter (October 1 to December 31)	14,000	1,820	15,820
Total	\$58,500	\$7,605	\$66,105

Draft Statement of Business or Professional Activities—CRA Form T2125

Part 2—Professional income

Part 2 – Professional income

☒ If you have professional income, tick this box and complete this part. **Do not complete parts 1 and 2 on the same form**

Gross professional fees including work-in-progress (WIP) (including GST/HST collected or collectible) \$66,105 00 D

Minus any GST/HST, provincial sales tax, returns, allowances, discounts, and GST/HST adjustments (included on line D above) \$7,605 00 (i)

and any WIP at the end of the year you elected to exclude (see Chapter 2 of Guide T4002) \$58,500 00 E

Subtotal (amount D minus amount (i))

For those using the quick method – Government assistance calculated as follows

GST/HST collected or collectible on professional fees eligible for the quick method (ii)

GST/HST remitted, calculated on (professional fees eligible for the quick method plus GST/HST collected or collectible) multiplied by the applicable quick method remittance rate (iii)

Subtotal (amount (ii) minus amount (iii)) \$0 00 (iv)

Work-in-progress (WIP), start of the year, per election to exclude WIP (see Chapter 2 of Guide T4002) \$0 00 (v)

Adjusted professional fees (Amount E plus amounts (iv) and (v)) – Enter this amount on line 8000 in Part 3 below \$58,500 00 F

Part 3—Gross business or professional income

Part 3 – Gross business or professional income

Adjusted gross sales (from amount C in Part 1) or adjusted professional fees (from amount F in Part 2) 8000 \$58,500 00 G

Plus

Reserves deducted last year 8290 \$0 00

Other income 8290 \$0 00

Total of the above two lines \$0 00 H

Gross business or professional income (amount G plus amount H) 8299 \$58,500 00

Enter this amount on the appropriate line of your income tax and benefit return: business on line 162; professional on line 164; or commission on line 166

Part 5—Net income (loss) before adjustments

Part 5 – Net income (loss) before adjustments

Protected B when completed

Gross profit from line 8519 in Part 4 on page 2, or gross income from line 8299 in Part 3 on page 2 \$58,500 00 K

Expenses (enter only the business part)

Advertising	8521	
Meals and entertainment (allowable part only)	8523	
Bad debts	8590	
Insurance	8690	\$2,500 00
Interest	8710	
Business tax, fees, licences, dues, memberships, and subscriptions	8760	\$2,000 00
Office expenses	8810	\$4,000 00
Supplies	8811	
Legal, accounting, and other professional fees	8860	\$2,000 00
Management and administration fees	8871	
Rent	8910	\$12,000 00
Maintenance and repairs	8960	
Salaries, wages, and benefits (including employer's contributions)	9060	\$25,000 00
Property taxes	9180	
Travel (including transportation fees, accommodations, and allowable part of meals)	9200	
Telephone and utilities	9220	\$800 00
Fuel costs (except for motor vehicles)	9224	
Delivery, freight, and express	9275	
Motor vehicle expenses (not including CCA) (see Chart A on page 6)	9281	\$4,770 00
Allowance on eligible capital property	9935	
Capital cost allowance (CCA) (from Area A on page 5)	9936	\$1,360 00
Other expenses (specify)	9270	
Total business expenses (total of lines 8521 to 9270)	9368	\$54,430 00
Net income (loss) before adjustments (amount K minus amount L)	9369	\$4,070 00

Part 6—Your net income (loss)

Part 6 – Your net income (loss)

Your share of the amount on line 9369 in Part 5 or the amount from your T5013 slip

\$4,070 00 M

Plus: GST/HST rebate for partners received in the year (see Chapter 3 of Guide T4002)

9874 \$0 00 N

Total (amount M plus amount N)

\$4,070 00

\$4,070 00 O

Minus: Other amounts deductible from your share of the net partnership income (loss) (from the chart in Part 7 below)

9943 P

Net income (loss) after adjustments (amount O minus amount P)

\$4,070 00 Q

Minus: Business-use-of-home expenses (your share of amount 3 in part 8)

9945 \$0 00 R

Your net income (loss) (amount Q minus amount R)

9946 \$4,070 00

Enter this amount on the appropriate line of your income tax and benefit return: business on line 135, professional on line 137, or commission on line 139